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UNITED STATES BANKRUPTCY COURT

NORTHERN DISTRICT OF CALIFORNIA

In re PACIFIC GAS AND ELECTRIC COMPANY	Case No. 01-30923 DM Chapter 11 Date: [not set for hearing] Time: Courtroom: 235 Pine Street, San Francisco

UNITED STATES TRUSTEE'S OBJECTION TO APPLICATION TO EMPLOY D.F. KING & CO., INC.

Linda Ekstrom Stanley, United States Trustee, submits this objection to the *Application for Authority to Employ D.F. King & Co., Inc.* (the "D. F. King Application"). The D.F. King Application should not be granted. The Application seeks Bankruptcy Court approval for an extra-judicial solicitation effort by D.F. King on behalf of debtor and PG&E Corporation who are the co-proponents of the *Plan of Reorganization under Chapter 11 of the Bankruptcy Code for Pacific Gas and Electric Company Proposed by Pacific Gas and Electric Company and PG&E*

Corporation (the "PG&E Plan").[1] The Application should not be approved for the further reasons that it fails to disclose D.F. King's relationship with PG&E Corporation and contains impermissible indemnity and choice of law provisions.

ARGUMENT

I. THE D.F. KING APPLICATION REQUESTS COURT APPROVAL FOR A SOLICITATION EFFORT THE COURT HAS NOT REVIEWED AND WOULD AUTHORIZE DISTRIBUTION OF MATERIALS AND ARGUMENT THE PROPONENTS HAVE NOT PRESENTED TO THE BANKRUPTCY COURT

The Plan Proponents want to hire D.F. King to act as a solicitation agent. The work D.F. King proposes to do must be distinguished from Innisfree, the other solicitation agent. Innisfree is responsible for mailing the solicitation package to creditors and other parties in interest, including the "street names" which are beneficial holders. D.F. King, on the other hand, will conduct the heavy-lifting of the solicitation effort. The firm will contact plan voters by "telephone, facsimile, email, in person and by mail," to solicit approval of the Plan. *Declaration of Edw. T. McCarthy in Support of Application for Authority to Employ D.F. King & Co, Inc.*, Exh. "A," page 2 (h) (hereafter, the "Engagement Letter.).

Neither the firm nor the Plan Proponents disclose any specifics about the kind of information they intend to supply plan voters. The Engagement Letter makes clear there are supplemental materials, though. The engagement agreement refers to "solicitation materials other than the initial voting packet," "handling document requests from requesting parties," "telephonic solicitation scripts," and "scripts for frequently asked questions."

Debtor should not be authorized to employ a firm like D.F. King to solicit votes using unapproved material and telephone "scripts." D.F. King undoubtedly will refer to itself as a "court-approved" solicitation agent in an effort to cast a favorable light on its efforts. It is far from unimaginable D.F.King's materials and its telephone, fax and e-mail pitches, none of which were submitted to the Bankruptcy Court, let alone approved, will bear the supposed imprimatur of the Bankruptcy Court for the Northern District of California, and the material will be presented as a supplement in aid of understanding the Court-approved disclosure

[1] For ease of reference, PG&E Corporation and debtor will be referred to as the "Plan Proponents."

statement. Any attempt to cloak D.F. King or the Plan Proponents' solicitation effort with Court approval should be prevented.

The employment of D.F. King is improper for the additional reason that the Plan Proponents may intend to distribute materials that ought to have been approved by the Bankruptcy Court if the Plan Proponents intended them to be distributed. Several courts have considered whether it is appropriate to permit post-petition solicitation of votes after a disclosure statement has been approved. Many courts acknowledge parties have a right to lobby votes on a plan after a disclosure statement has been approved, an unremarkable conclusion. *See, e.g., Century Glove v. First. Am. Bank of New York*, 860 F.2d 94, 101 (3d Cir. 1988); *In re Dow Corning Corp.*, 227 B.R. 111, 118 (Bankr. E.D. Mich 1998).

Less certain, however, is a party's right to solicit votes on a plan using information outside the scope of the approved solicitation materials. The few cases discussing this issue agree solicitation may be permissible, but it had better be accurate. In *In re Kellogg Square Partnership*, 160 B.R. 336 (Bankr. D. Minn. 1993), the court approved the use of extra-judicial material for plan solicitation but cautioned the material could not "contradict the court-approved disclosure statement, or contain mischaracterizations or misstatements of material fact that might unfairly influence solicitees . . . " *Id* at 341. Likewise, the bankruptcy court in *In re Media Central, Inc.*, 89 B.R. 685 (Bankr. E.D. Tenn. 1988), stated:

> The disclosure statement hearing gives interested parties the opportunity to challenge whether certain statements or information contained in the disclosure statement should be sent out to those who will vote on a plan. Failure to obtain beforehand a judicial ruling on the propriety of statements or information sent in conjunction with a vote solicitation may lead to a vote disqualification after the fact if it is later determined that the statements or information were improper and the solicitation in bad faith.

Id. at 691.

Debtor and PG&E Corporation's use of D.F. King to carry out an e-mail and telephone solicitation effort is just as troubling as their intention to supply unapproved documents to voters. The Engagement Letter refers to scripts and "other similar material or tools developed by King for use in providing services under this agreement." Engagement Letter

¶ 4. None of these materials were supplied in advance and the United States Trustee is concerned they may be inconsistent with the Court-approved disclosures mandated by § 1125.

In any event, the requirement that a solicitation effort must be fully consistent with the Bankruptcy Code and its purposes is also found in the Bankruptcy Code itself. Section 1125(e), the safe harbor, provides "a person that solicits acceptance of or rejection of a plan, in good faith *and in compliance* with the applicable provisions of this title . . . is not liable, on account of such solicitation or participation, for violation of any applicable law, rule, or regulation. . . " 11 U.S.C. § 1125(e) (emphasis added). Section 1125(e) demonstrates Congress's view that a solicitation effort is an important part of any Court-supervised reorganization and that efforts made to garner votes for a plan be consistent with that Court's supervision.

The employment of D.F. King should not be authorized because the proposed employment does not appear to be consistent with the Court's supervision of this reorganization to date and because it would confer an air of respectability on the Plan Proponent's solicitation effort the Bankruptcy Court does not authorize.

II. D.F. KING IS NOT DISINTERESTED BECAUSE IT HAS BEEN EMPLOYED BY PG&E CORPORATION

Any professional seeking to be employed by a bankruptcy estate under 11 U.S.C. § 327(a) must demonstrate it has no conflict of interest and is disinterested. D.F. King did not disclose among its connections that it has represented PG&E Corporation, one of the Plan Proponents, as recently as March 2002. In a Joint Proxy Statement mailed beginning March 13, 2002, PG&E Corporation stated "PG&E Corporation and Pacific Gas and Electric Company hired D.F. King & Co., Inc. to assist in the distribution of proxy materials and solicitation of votes." (A copy of pages 1 through 5 of the Proxy Statement is attached hereto as Exhibit "A.")

D.F. King is disqualified from representing debtor in the solicitation effort. PG&E Corporation holds an interest adverse to the estate: it is debtor's principal stockholder and shares the same board of directors save one member. 11 U.S.C. § 327(a). D.F. King is not

disinterested because it has an interest "materially adverse to the estate" because its principal work is for PG&E Corporation, the parent and publicly traded entity. 11 U.S.C. § 101(14). D.F. King's has been engaged to ensure interested parties approve the plan; this effort takes little or no proven account of the individual interests of debtor. D.F. King should not serve the estate.

III. D.F. KING'S ENGAGEMENT LETTER CONTAINS IMPERMISSABLE TERMS REQUIRING THE ESTATE TO 'INDEMNIFY' IT AND CALLING FOR THE USE OF NEW YORK LAW AND NEW YORK COURTS IN THE EVENT OF ANY DISPUTES

A. Indemnity Provisions Do Not Comply with Bankruptcy Law

D.F. King's Engagement contains a classic indemnity provision:

> The Company [debtor] agrees to hold harmless and indemnify King, King's controlling persons and officers, directors, employees and agents . . . from and against all losses, claims, damages, liabilities, disbursements and expenses (including but not limited to, reasonable attorneys' fees and expenses) incurred . . . in connection with any claim arising out of, relating to, or in connection with the Services and / or the Solicitation and / or matters relating there to . . provided, however, that the company shall not be liable for any indemnification to the extent that any such suit, action, proceeding, claim, damage , loss, liability or expenses results from . . . gross negligence or wilful misconduct.

Engagement Letter ¶ 7. Further details regarding legal defense are provided at paragraph 8 of the Engagement Letter.

The United States Trustee objects to such indemnity provisions because they are unjustified. The terms are not in the best interests of the estate. The terms provide no value to the estate. An indemnity is particularly inappropriate here because the plan has two proponents, debtor and PG&E Corporation, yet the proposed employment would impose the entire burden of indemnity on the estate and none on PG&E Corporation.

The indemnity provisions would immunize D.F. King from its own professional malpractice, gross negligence, fraud, or other intentional misconduct and shift the risk of any third party claims arising therefrom completely to the estate. The great weight of authority rejects indemnity and other liability protections as an inappropriate and unacceptable terms

of employment for a bankruptcy estate professional. *In re Gillett Holdings, Inc.*, 137 B.R. 452, 458 (Bankr. D. Colo. 1991) (entirely improper and unacceptable); *In re Drexel Burnham Lambert Group*, 133 B.R. 13, 27 (Bankr. S.D.N.Y. 1991) ("[s]imply stated, indemnification agreements are inappropriate"); *In re Mortgage & Realty Trust*, 123 B.R. 626, 631 (Bankr. C.D. Cal. 1991) ("[i]ndemnification is not consistent with professionalism"); *In re Allegheny Int'l, Inc.*, 100 B.R. 244, 247 (Bankr. W.D. Pa. 1989) ("holding a fiduciary harmless for its own negligence is shockingly inconsistent with the strict standard of conduct for fiduciaries"); *In re United Companies Financial Corp.*, 241 B.R. 521, 524 (Bankr. D. Del. 1999) (disapproving financial advisors' use of indemnification provision and damages cap).

B. The Agreement to Have Disputes Decided in New York Pursuant to New York Law Is Not Consistent with this Court's Jurisdiction to Control Employment Terms and Fees

The Engagement Letter also contains a "choice of law provision" (New York) and a provision requiring the use of New York courts. Engagement Letter ¶ 10. The employment term requiring use of New York courts and New York law should also be rejected. Professionals employed under the authority of a California bankruptcy court must rely on federal law and the United States Bankruptcy Court for protection in the first instance. Choice of law terms are inconsistent with Bankruptcy Code §§ 327 - 330, which give this court exclusive control of employment terms and fees in bankruptcy cases. *See In re Shirley*, 134 B.R. 940, 943-44 (Bankr. 9th Cir. 1992), ("Bankruptcy Code and Federal Rules of Bankruptcy Procedure operate to preclude fee awards for services performed on behalf of a bankruptcy estate based on state law theories not provided for by the Code"). *Accord*, *In re Atkins*, 69 F.3d 970, 973 (9th Cir. 1995); and *In re Weibel*, 176 B.R. 209, 211 (9th Cir. BAP 1994).

For the foregoing reasons, the United States Trustee objects to an order of employment for D.F. King.

Dated: June 18, 2002

Respectfully submitted,

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By:_____
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